

Tennessee Local Development Authority

**For the Year Ended
June 30, 2002**

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**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

April 3, 2003

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Members of the Tennessee Local Development Authority
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Local Development Authority for the year ended June 30, 2002. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/mb
02/093

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Tennessee Local Development Authority
For the Year Ended June 30, 2002

AUDIT OBJECTIVES

The objectives of the audit were to consider the authority's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts (including the bond resolutions); to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

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Audit Report
Tennessee Local Development Authority
For the Year Ended June 30, 2002

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Tennessee Local Development Authority For the Year Ended June 30, 2002

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Local Development Authority. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The Tennessee Local Development Authority was created April 2, 1978, by an act of the General Assembly, codified as Title 4, Chapter 31, *Tennessee Code Annotated*. The authority is delegated the responsibility for issuing its debt obligations to provide funds to make loans to local governments for the State Loan Program and for capital projects; certain small business concerns for pollution control facilities; farmers for certain capital improvements; counties for the acquisition of equipment for use by county or volunteer fire departments serving unincorporated areas of the counties; airport authorities and municipal airports; and mental health/retardation/alcohol and drug facilities (the Community Provider Pooled Loan Program). To date, the authority has issued debt only to fund the State Loan Program and the Community Provider Pooled Loan Program.

ORGANIZATION

The Tennessee Local Development Authority is composed of the Governor, the Secretary of State, the Comptroller of the Treasury, the State Treasurer, the Commissioner of Finance and Administration, and two other members—one appointed by the Speaker of the Senate from nominations by the Tennessee County Services Association and the other by the Speaker of the House from Nominations by the Tennessee Municipal League. The Governor serves as Chairman, and the Comptroller of the Treasury serves as Secretary.

An organization chart for the Tennessee Local Development Authority is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 2001, through June 30, 2002, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2002. The Tennessee Local Development Authority has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

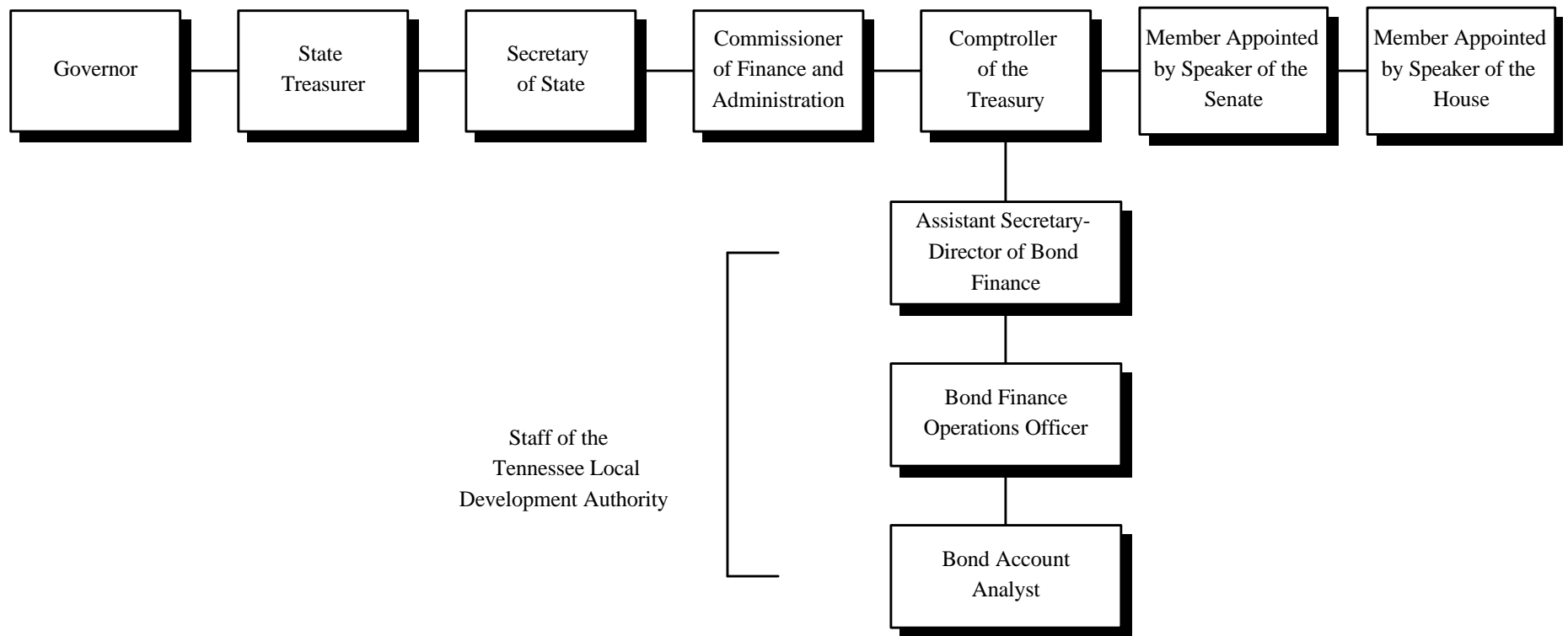
1. to consider the authority's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, and contracts (including the bond resolutions);
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY

ORGANIZATION CHART



RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Tennessee Local Development Authority's financial statements for the year ended June 30, 2002, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the Tennessee Local Development Authority's financial statements.



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT**

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NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765**

**Report on Compliance and on Internal Control
Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance With
*Government Auditing Standards***

December 20, 2002

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of the Tennessee Local Development Authority, a component unit of the State of Tennessee, as of and for the year ended June 30, 2002, and have issued our report thereon dated December 20, 2002. As discussed in Note 1 to the financial statements, the Tennessee Local Development Authority implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the authority's financial statements are free of material misstatement, we performed tests of the authority's compliance with certain provisions of laws, regulations, and contracts (including the bond resolutions), noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The Honorable John G. Morgan
December 20, 2002
Page Two

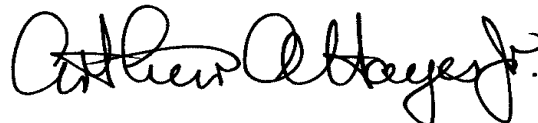
The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

A handwritten signature in black ink, reading "Arthur A. Hayes, Jr." with a stylized, cursive script.

Arthur A. Hayes, Jr., CPA,
Director

AAH/mb



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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Independent Auditor's Report

December 20, 2002

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of net assets of the Tennessee Local Development Authority ("the Authority"), a component unit of the State of Tennessee, as of June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2002, and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the Authority implemented Government Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*.


The Honorable John G. Morgan
December 20, 2002
Page Two

The management's discussion and analysis section is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements, taken as a whole. The accompanying financial information on pages 23 through 25 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 2002, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts (including bond resolutions). That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Arthur A. Hayes, Jr.", with a stylized, cursive script.

Arthur A. Hayes, Jr., CPA,
Director

AAH/dlj

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the Tennessee Local Development Authority (the "Authority"), we offer readers of the Authority's financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal year ended June 30, 2002.

Program Activity Highlights

The Authority's purpose is to provide loans to Local Government Units under the State Loan Program, and to qualified borrowers under the Community Provider Loan program. The table below summarizes this business activity.

	<u>State Loan Program</u>		<u>Community Providers</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Number of borrowers with outstanding loans	60	60	18	19
Total number of outstanding loans	114	115	24	26
Total amount of outstanding loans	\$82,685,464	\$83,118,012	\$12,360,192	\$13,236,064
Number of loans approved in fiscal year	2	0	0	0
Amount of loans funded in fiscal year	\$11,810,000	0	0	0

The financial statements and the analysis provided in the remainder of this report reflect the financial results of this activity. For more specific financial information on long-term debt activity, see Note 5, Notes and Bonds Payable, in the Notes to the Financial Statements.

Debt Administration

Pursuant to Title 4, Chapter 31, *Tennessee Code Annotated*, the General Assembly of the state created the Tennessee Local Development Authority to issue bonds and notes to fund capital projects for a variety of purposes. Currently, the active programs of the Authority include

- 1) the State Loan Program, which provides assistance to Local Government Units in the construction of waterworks, sewage treatment, and energy and/or solid waste recovery facilities; and
- 2) the Community Provider Program, which provides facility construction assistance to licensed, nonprofit, 501(c)(3) corporations under grant contracts with the state to deliver mental health, mental retardation, or alcohol and drug services.

A financial analysis of each loan in the State Loan Program is undertaken before it is approved by the Authority. Each Local Government Unit must demonstrate rates and fees sufficient to repay the debt, including operations, maintenance, and depreciation. The Authority is authorized

to intercept the local community's state-shared taxes, should the government unit fail to repay timely its loan. Similarly, Community Providers must also charge fees sufficient to repay the debt, including operations, maintenance, and depreciation. The Authority is also authorized by statute to intercept the state appropriation to the Community Provider if the borrower fails to make timely debt service payments to the Authority.

Under the financing program for the State Loan Program, during the construction phase of a project, the project generally is funded through the issuance of Bond Anticipation Notes. When sufficient projects are completed to assure an economy of scale, the Authority fixes the interest rate for the term of the project by issuing long-term debt. Interest rates on the State Loan Program facilities long-term fixed-rate loans range from a low of 2.5% to a high of 7.25%. By pooling the financing of their capital needs, management believes that economic efficiencies of a single large borrowing administered by one agency were achieved. The creditworthiness of both large and small Local Government Units is homogenized into one credit resulting in a lower cost of borrowing.

The Authority's State Loan Program is rated A+, A1, and AA by Fitch, Moody's Investors Service, and Standard & Poor's Rating Group, respectively. Fitch comments that the rating reflects the debt security provisions and the quality administration of the program. Standard & Poor's cites the financial strength of the local governments receiving loans. Moody's commented that the responsibility of the localities to repay loans, the high credit quality of the loan recipients, and the long-term trend of sound portfolio performance were factors in the rating process.

The Community Provider program was originally authorized in 1990 by the legislature to provide construction financing for eligible borrowers at interest rates lower than would otherwise be obtainable from private industry. The program was initially funded through the issuance of the 1992 and the 1994 Community Provider bonds. In 1999, the state issued general obligation, taxable commercial paper to defease the 1992 and 1994 bonds. The commercial paper interest rates to the Community Provider Program have ranged from 1.83% to 3.76% during fiscal year 2002.

Overview of the Financial Statements

The Authority is a discretely presented component unit of the State of Tennessee and uses enterprise fund accounting. The financial statements are prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Under the economic resources measurement focus, a reader is presented information that allows him to determine the transactions and events that have increased or decreased the total economic resources for the period.

This discussion and analysis are intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements comprise two components: 1) the basic financial statements and 2) notes to the financial statements. The basic financial statements are comprised of three separate and distinct statements. The Statement of Net Assets depicts the Authority's financial position at June 30, 2002. The Statement of Revenues, Expenses, and Changes in Net Assets reports the results of inflows and outflows and the change in net assets for the year. The Statement of Cash Flows summarizes the sources and uses of cash throughout the fiscal year. These statements are accompanied by notes to the financial statements that provide information that is essential to the reader's understanding of the financial statements. This report also contains supplementary information containing financial statement information at the program level in addition to the basic financial statements and notes.

Financial Analysis of the Authority

Standard indicators of financial success are not applicable to the Authority. The financial goal of the Authority is to provide timely access to the capital markets at the lowest possible cost. The Authority successfully achieved this goal. There were no incidents requiring the Authority to draw from the debt service reserve fund or refuse a loan from an applicant due to the inability to obtain capital funding.

Statements of Net Assets Summary (in thousands)			
	<u>2002</u>	<u>2001</u>	<u>% Change</u>
Current assets	\$ 33,040	\$ 29,807	10.8%
Noncurrent assets	<u>96,947</u>	<u>98,750</u>	(1.8%)
Total assets	<u>129,987</u>	<u>128,557</u>	1.1%
Current liabilities	57,397	51,205	12.1%
Noncurrent liabilities	<u>58,739</u>	<u>64,334</u>	(8.7%)
Total liabilities	<u>116,136</u>	<u>115,539</u>	.5%
Net assets:			
Restricted net assets	351	661	(46.9%)
Unrestricted net assets	<u>13,500</u>	<u>12,357</u>	9.2%
Total net assets	\$ <u>13,851</u>	\$ <u>13,018</u>	6.4%
<i>Note: The Authority owns no capital assets.</i>			

Current assets include cash of \$11,138,544 representing unexpended note proceeds available to fund loans to State Loan Program eligible borrowers. The Authority issued \$51,000,000 in State Loan Program Bond Anticipation Notes during the fiscal year. It also redeemed \$44,500,000 of prior Bond Anticipation Notes. Debt matured and was repaid in the amount of \$6,958,000. The Community Provider program redeemed commercial paper in the amount of \$1,500,000 with payments made by borrowers. The unrestricted net assets are available to fund operations and other expenses necessary to meet the goals of the Authority.

Statements of Revenues, Expenses, and Changes in Net Assets Summary (in thousands)			
	<u>2002</u>	<u>2001</u>	<u>% Change</u>
Operating Revenues			
Revenue from loans	\$ 5,321	\$ 5,948	(10.5%)
Investment earnings	<u>870</u>	<u>1,735</u>	(49.9%)
Total operating revenue	<u>6,191</u>	<u>7,683</u>	(19.4%)
Operating Expenses			
Interest expense	4,563	5,755	(20.7%)
Subsidy to borrowers	655	856	(23.5%)
Other expenses	<u>165</u>	<u>208</u>	(20.7%)
Total expenses	<u>5,383</u>	<u>6,819</u>	(21.1%)
Operating Income	<u>808</u>	<u>864</u>	(6.5%)
Nonoperating Revenue	<u>25</u>	<u>25</u>	0.0%
Increase in Net Assets	\$ <u>833</u>	\$ <u>889</u>	(6.3%)

The Authority's operating expenses are supported by revenue received from the borrowers as a one-time 2% cost of issuance fee at the time of permanent financing, interest on loans, and income on investments. Operating expenses include interest expense on outstanding debt, administrative expenses, and the amortization of bond costs of issuance. Interest expense decreased because the interest rates on the Bond Anticipation Notes and the loan from the state of Tennessee decreased. In addition, the interest expense also decreased as the balance of debt payable decreased. The Authority returns a portion of the investment earnings as a subsidy to its borrowers in the State Loan Program.

The decrease in the operating income was most affected by a decrease in investment earnings. The investment earnings are a function of prevailing market interest rates and the daily invested balance. During the year ended June 30, 2002, the capital markets were affected by a declining economy and the economic effect of the terrorist actions. As a result, the average interest rate on investments was significantly lower in fiscal year 2002 than in fiscal year 2001.

Contacting the Authority's Financial Management Team

This discussion and analysis is designed to provide our citizens, Local Government Units, Community Providers, investors, and creditors with a general overview of the Authority's finances and to demonstrate its accountability for the monies it receives. If you have questions about this report or need additional financial information, contact the Director of Bond Finance, State of Tennessee, Suite 1600, James K. Polk Building, Nashville, Tennessee 37243-0273 or visit our website at www.comptroller.state.tn.us/cpdivbf.htm.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
STATEMENT OF NET ASSETS
JUNE 30, 2002

(Expressed in Thousands)

ASSETS

Current assets:

Cash (Note 2)	\$ 27,483
Receivables:	
Loans receivable	5,056
Interest receivable on loans	20
Investments (Note 2)	299
Interest receivable on investments	182

Total current assets	<u>33,040</u>
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Noncurrent assets:

Restricted assets (Notes 2 and 3)	
Investments	6,634
Loans receivable	89,989
Deferred charges	324

Total noncurrent assets	<u>96,947</u>
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Total assets	<u>129,987</u>
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LIABILITIES

Current liabilities:

Accrued interest payable	1,040
Payable to borrowers (Note 4)	619
Notes payable (Note 5)	51,513
Revenue bonds payable (Note 5)	4,225

Total current liabilities	<u>57,397</u>
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Noncurrent liabilities:

Loan from the State of Tennessee (Note 5)	12,300
Revenue bonds payable, net (Note 5)	46,439

Total noncurrent liabilities	<u>58,739</u>
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Total liabilities	<u>116,136</u>
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NET ASSETS

Restricted	351
Unrestricted	13,500

Total net assets	<u>\$ 13,851</u>
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The Notes to the Financial Statements are an integral part of this statement.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2002

(Expressed in Thousands)

OPERATING REVENUES

Revenue from loans	\$ 5,321
Interest income	985
Net (decrease) in fair value of investments	<u>(115)</u>
Total operating revenues	<u>6,191</u>

OPERATING EXPENSES

Interest expense	4,563
Subsidy to borrowers	655
Bond issuance cost	25
Administrative expense	<u>140</u>
Total operating expenses	<u>5,383</u>
Operating income	<u>808</u>

NONOPERATING REVENUE

Payment from the State of Tennessee	<u>25</u>
Total nonoperating revenue	<u>25</u>
Change in net assets	<u>833</u>
Net assets, July 1	<u>13,018</u>
Net assets, June 30	\$ <u><u>13,851</u></u>

The Notes to the Financial Statements are an integral part of this statement.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2002

(Expressed in Thousands)

CASH FLOWS FROM OPERATING ACTIVITIES

Payments to service providers	\$ (140)
Net cash used by operating activities	<u>(140)</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Proceeds from the sale of notes	51,541
Principal payments	(50,025)
Interest paid	(5,209)
Subsidy to borrowers	(891)
Payment from the State of Tennessee	<u>25</u>
Net cash used by noncapital financing activities	<u>(4,559)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Loans issued	(8,976)
Collections of loan principal	10,251
Interest received on loans	5,311
Interest received on investments	<u>985</u>
Net cash provided by investing activities	<u>7,571</u>
Net increase in cash	2,872
Cash, July 1	<u>24,611</u>
Cash, June 30	\$ <u><u>27,483</u></u>

**Reconciliation of operating income to net cash
used by operating activities:**

Operating income	\$ <u>808</u>
Adjustments to reconcile operating income to net cash used by operating activities:	
Amortization	25
Revenue from loans	(5,321)
Investment income	(870)
Interest expense	4,563
Subsidy to borrowers	<u>655</u>
Total adjustments	<u>(948)</u>
Net cash used by operating activities	\$ <u><u>(140)</u></u>

Noncash investing activities:

(Decrease) in fair value of investments	\$ (115)
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The Notes to the Financial Statements are an integral part of this statement.

Tennessee Local Development Authority
Notes to the Financial Statements
June 30, 2002

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Tennessee Local Development Authority was created to provide financial assistance to local governments through the issuance of revenue bonds or notes. The authority has also issued bonds to assist nonprofit corporations in the construction of mental health, mental retardation, or alcohol and drug facilities. In accordance with the Governmental Accounting Standards Board's Statement No. 14, *The Reporting Entity*, the authority is reported as a discretely presented component unit in the *Tennessee Comprehensive Annual Financial Report*. Although the authority is a separate legal entity, its board consists primarily of state officials, and therefore, the state has the ability to affect the day-to-day operations of the authority.

Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Tennessee Local Development Authority follows all applicable GASB pronouncements as well as applicable private sector pronouncements issued on or before November 30, 1989.

Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

The Tennessee Local Development Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with principal ongoing operations. The authority's principal operation is to provide loans to local governments through the issuance of revenue bonds or notes. Therefore, the principal operating revenues of the authority are from interest on loans made to borrowers. The authority also recognizes income on investments as operating revenue. The authority's operating expenses include interest paid on borrowings, subsidies to borrowers, bond issuance costs, arbitrage, and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Tennessee Local Development Authority
Notes to the Financial Statements (Cont.)
June 30, 2002

Investments

Investments are stated at fair value.

Bond Discounts and Issuance Costs

Bond discounts and issuance costs are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable unamortized bond discount. Unamortized issuance costs are reported as deferred charges.

New Accounting Pronouncement

Effective July 1, 2001, the authority adopted GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*. To conform to the requirements of GASB 34, the following changes have been made to the authority’s financial statements:

- A. Retained Earnings have been reclassified into the following categories of Net Assets: invested in capital assets, net of related debt; restricted; and unrestricted. (The Authority has no net assets invested in capital assets.)
- B. The statement of financial position is now presented in a statement of net assets format rather than a balance sheet format.
- C. Management’s Discussion and Analysis has been added as required supplementary information.

NOTE 2. DEPOSITS AND INVESTMENTS

Deposits. Under the general bond resolution of the Tennessee Local Development Authority, the funds of the authority are to be deposited with the State Treasurer and can be invested in any security deemed acceptable to Treasury standards.

The fund had \$27,482,621 in the State Treasurer’s pooled investment fund at June 30, 2002.

The pooled investment fund administered by the State Treasurer is authorized by state statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime

Tennessee Local Development Authority
Notes to the Financial Statements (Cont.)
June 30, 2002

commercial paper, prime bankers' acceptances, certain repurchase agreements, various U.S. Treasury and agency obligations, and in obligations of the State of Tennessee pursuant to Section 9-4-602(b), *Tennessee Code Annotated*. The pooled investment fund is also authorized to enter into securities lending agreements in which U.S. government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The State Treasurer's pooled investment fund's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report*.

Investments. Investments are required to be categorized to indicate the level of custodial risk assumed by the authority. All of the authority's investments are category 1, which consists of investments that are insured or registered or for which the securities are held by the authority or its agent in the authority's name.

Authority investments at June 30, 2002, are categorized below (expressed in thousands):

	<u>Category 1</u>
	<u>Fair Value</u>
U.S. Treasury Notes	\$5,734
U.S. Treasury Securities-State and Local Government Series	<u>1,199</u>
Total investments	<u>\$6,933</u>

NOTE 3. RESTRICTED ASSETS

The general bond resolution of the authority requires that the principal of each bond issue include an amount equal to one year's debt service requirement and that such amount be placed in special trust accounts with the trustee. The required debt service reserve is \$6,634,355 at June 30, 2002.

NOTE 4. PAYABLE TO BORROWERS

This account represents interest earnings on restricted assets and loan principal overpayments that will be refunded to borrowers.

Tennessee Local Development Authority
Notes to the Financial Statements (Cont.)
June 30, 2002

NOTE 5. NOTES AND BONDS PAYABLE

Notes. Revenue bond anticipation notes in the amount of \$51,000,000 were issued in June 2002 to retire at maturity the \$44,500,000 notes issued in 2001 and provide additional loan funds to local government units for water and sewer construction projects.

Notes payable at June 30, 2002, are as follows (expressed in thousands):

	<u>June 30, 2002</u>
Revenue bond anticipation notes, 1.66%, issued June 12, 2002, maturing June 11, 2003 (includes unamortized premium of \$513)	<u>\$ 51,513</u>
Total notes payable	<u>\$ 51,513</u>

Short-term debt activity for the year net of unamortized premium (expressed in thousands):

<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
\$45,025	\$51,513	\$45,025	\$51,513

Revenue bonds. Bonds payable at June 30, 2002, are as follows (expressed in thousands):

	<u>June 30, 2002</u>
Refunding revenue bonds, 4.0% to 7.25%, issued January 14, 1987, due in various amounts of principal and interest from \$.2 million in 2003 to \$.9 million in 2015 (net of unamortized discount of \$608 at June 30, 2002)	\$ 3,713
Refunding revenue bonds, 2.5% to 5.75%, issued July 7, 1993, due in various amounts of principal and interest from \$3.5 million in 2003 to \$2.1 million in 2011	17,805
Refunding revenue bonds, 4.75% to 5.125%, issued November 1, 1997, due in various amounts of principal and interest from \$3.3 million in 2003 to \$.015 million in 2022 (net of unamortized discount of \$61 and deferred amount on	

Tennessee Local Development Authority
Notes to the Financial Statements (Cont.)
June 30, 2002

refunding of \$1,473 at June 30, 2002)	<u>29,146</u>
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Net bonds payable	<u>\$ 50,664</u>
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Debt service requirements to maturity of the revenue bonds payable at June 30, 2002, are as follows (expressed in thousands):

<u>For the Year(s)</u> <u>Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2003	\$ 4,225	\$ 2,732	\$ 6,957
2004	4,115	2,519	6,634
2005	4,255	2,307	6,562
2006	3,545	2,087	5,632
2007	3,265	1,905	5,170
2008-2012	18,273	6,755	25,028
2013-2017	13,418	2,402	15,820
2018-2022	<u>1,710</u>	<u>189</u>	<u>1,899</u>
 Total	 <u>\$ 52,806</u>	 <u>\$ 20,896</u>	 <u>\$ 73,702</u>

Loan from the State of Tennessee. On June 2, 1999, the State Funding Board loaned \$16,000,000 to the authority for the Community Provider program. The loan is to be repaid from amounts received from the borrowers. Interest is accrued at a variable rate. The authority has repaid \$3,700,000 as of June 30, 2002.

Long-term debt activity for the year net of unamortized discounts and deferred amount on refunding (expressed in thousands):

	<u>Beginning</u> <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending</u> <u>Balance</u>
Bonds	\$54,559	-	\$3,895	\$50,664
Loan	\$13,800	-	\$1,500	\$12,300

Tennessee Local Development Authority
Notes to the Financial Statements (Cont.)
June 30, 2002

NOTE 6. PRIOR YEAR DEFEASANCE OF DEBT

Prior to fiscal year 2001, the authority defeased certain revenue bonds of the Community Provider Program by placing the proceeds of general obligation notes in an irrevocable trust to provide for all future debt service payments on the defeased bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the financial statements of the authority. On June 30, 2002, \$19,190,000 of bonds outstanding were considered defeased.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
SUPPLEMENTARY STATEMENT OF NET ASSETS - PROGRAM LEVEL
JUNE 30, 2002

(Expressed in Thousands)			
	State Loan Program	Community Providers	Total
ASSETS			
Current assets:			
Cash	\$ 26,942	\$ 541	\$ 27,483
Receivables:			
Loans receivable	4,225	831	5,056
Interest receivable on loans	4	16	20
Investments	299	-	299
Interest receivable on investments	182	-	182
Total current assets	<u>31,652</u>	<u>1,388</u>	<u>33,040</u>
Noncurrent assets:			
Restricted assets			
Investments	6,634	-	6,634
Loans receivable	78,460	11,529	89,989
Deferred charges	324	-	324
Total noncurrent assets	<u>85,418</u>	<u>11,529</u>	<u>96,947</u>
Total assets	<u>117,070</u>	<u>12,917</u>	<u>129,987</u>
LIABILITIES			
Current liabilities:			
Accrued interest payable	981	59	1,040
Payable to borrowers	601	18	619
Notes payable	51,513	-	51,513
Revenue bonds payable	4,225	-	4,225
Total current liabilities	<u>57,320</u>	<u>77</u>	<u>57,397</u>
Noncurrent liabilities:			
Loan from the State of Tennessee	-	12,300	12,300
Revenue bonds payable, net	46,439	-	46,439
Total noncurrent liabilities	<u>46,439</u>	<u>12,300</u>	<u>58,739</u>
Total liabilities	<u>103,759</u>	<u>12,377</u>	<u>116,136</u>
NET ASSETS			
Restricted	351	-	351
Unrestricted	12,960	540	13,500
Total net assets	<u>\$ 13,311</u>	<u>\$ 540</u>	<u>\$ 13,851</u>

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
SUPPLEMENTARY STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS - PROGRAM LEVEL
FOR THE YEAR ENDED JUNE 30, 2002

	(Expressed in Thousands)		
	<u>State Loan Program</u>	<u>Community Providers</u>	<u>Total</u>
OPERATING REVENUES			
Revenue from loans	\$ 4,349	\$ 972	\$ 5,321
Interest income	966	19	985
Net (decrease) in fair value of investments	<u>(115)</u>	<u>-</u>	<u>(115)</u>
Total operating revenues	<u>5,200</u>	<u>991</u>	<u>6,191</u>
OPERATING EXPENSES			
Interest expense	4,240	323	4,563
Subsidy to borrowers	639	16	655
Bond issuance cost	25	-	25
Administrative expense	<u>139</u>	<u>1</u>	<u>140</u>
Total operating expenses	<u>5,043</u>	<u>340</u>	<u>5,383</u>
Operating income	<u>157</u>	<u>651</u>	<u>808</u>
NONOPERATING REVENUE			
Payment from the State of Tennessee	<u>25</u>	<u>-</u>	<u>25</u>
Total nonoperating revenue	<u>25</u>	<u>-</u>	<u>25</u>
Change in net assets	<u>182</u>	<u>651</u>	<u>833</u>
Net assets, July 1	<u>13,129</u>	<u>(111)</u>	<u>13,018</u>
Net assets, June 30	\$ <u><u>13,311</u></u>	\$ <u><u>540</u></u>	\$ <u><u>13,851</u></u>

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
SUPPLEMENTARY STATEMENT OF CASH FLOWS - PROGRAM LEVEL
FOR THE YEAR ENDED JUNE 30, 2002

(Expressed in Thousands)

	<u>State Loan Program</u>	<u>Community Providers</u>	<u>Total</u>
CASH FLOWS FROM OPERATING ACTIVITIES			
Payments to service providers	\$ (139)	\$ (1)	\$ (140)
Net cash used by operating activities	<u>(139)</u>	<u>(1)</u>	<u>(140)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Proceeds from the sale of notes	51,541	-	51,541
Principal payments	(48,525)	(1,500)	(50,025)
Interest paid	(4,807)	(402)	(5,209)
Subsidy to borrowers	(781)	(110)	(891)
Payment from the State of Tennessee	<u>25</u>	<u>-</u>	<u>25</u>
Net cash used by noncapital financing activities	<u>(2,547)</u>	<u>(2,012)</u>	<u>(4,559)</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Loans issued	(8,976)	-	(8,976)
Collections of loan principal	9,373	878	10,251
Interest received on loans	4,345	966	5,311
Interest received on investments	<u>966</u>	<u>19</u>	<u>985</u>
Net cash provided by investing activities	<u>5,708</u>	<u>1,863</u>	<u>7,571</u>
Net increase (decrease) in cash	3,022	(150)	2,872
Cash, July 1	<u>23,920</u>	<u>691</u>	<u>24,611</u>
Cash, June 30	\$ <u><u>26,942</u></u>	\$ <u><u>541</u></u>	\$ <u><u>27,483</u></u>
Reconciliation of operating income to net cash used by operating activities:			
Operating income	\$ <u>157</u>	\$ <u>651</u>	\$ <u>808</u>
Adjustments to reconcile operating income to net cash used by operating activities:			
Amortization	25	-	25
Revenue from loans	(4,349)	(972)	(5,321)
Investment income	(851)	(19)	(870)
Interest expense	4,240	323	4,563
Subsidy to borrowers	<u>639</u>	<u>16</u>	<u>655</u>
Total adjustments	<u>(296)</u>	<u>(652)</u>	<u>(948)</u>
Net cash used by operating activities	\$ <u><u>(139)</u></u>	\$ <u><u>(1)</u></u>	\$ <u><u>(140)</u></u>
Noncash investing activities:			
(Decrease) in fair value of investments	\$ (115)	\$ -	\$ (115)